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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 451

WALTER R. LAUDENSLAGER and MARGUERITE LAUDENSLAGER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FROM THE UNITED STATES COURT OF APPEALS IN THE THIRD CIRCUIT.

PETITION FOR WRIT OF CERTIORARI AND APPENDIX.

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COMMISSIONER OF INTERNAL REVENUE,
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ON PETITION FROM THE UNITED STATES COURT OF APPEALS IN THE THIRD CIRCUIT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners, Walter R. Laudenslager and Marguerite Laudenslager, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in this case on June 27, 1962.

Opinions Below.

The opinion of the Tax Court (R. 14a-21a) is reported at 20 T. C. M. 336. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-11a) is not yet reported.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 27, 1962 (Appendix A, *infra*, pp. 1a-11a). The jurisdiction of this Court is invoked under 28 U. S. C., section 1254.

Question Presented.

Taxpayer and Brewster entered into an agreement pursuant to which Brewster excavated fill material, comprising ordinary, sandy loam, from predetermined areas of taxpayer's property, and pursuant to which Brewster agreed to pay the taxpayer five cents per cubic yard of material extracted.

The following question is presented:

Whether the taxpayer's receipts are proceeds from the sale of capital assets and, hence, taxable as capital gain, or are payments taxable as ordinary income subject to depletion.

The Statutes Involved Are:

A. With respect to 1953:

Section 117 of the Internal Revenue Code of 1939, and particularly subsections (a), (b) and (j).

B. With respect to 1954:

Sections 1202, 1221 and 1231 (a) of the Internal Revenue Code of 1954.

The pertinent portions of the Statutes are set forth, at length, in Appendix B, *infra*, pp. 13a-14a.

Statement.

Petitioners are husband and wife. On their joint income tax returns for 1953 and 1954, they reported the proceeds from the transaction described below as capital gain income (R. 15a). On audit, the Commissioner of Internal Revenue, considered that such proceeds were taxable as ordinary income and asserted income tax deficiencies for both years.

In 1953 petitioners and George M. Brewster & Son, Inc. (Brewster), a road building contractor who required earth fill for a nearby construction job, entered into an agreement pursuant to which Brewster excavated and removed such earth fill from areas of petitioners property which the parties specifically delineated as to area and depth of excavation (R. 9a-13a), Brewster agreed to pay for the material so removed at the rate of five cents per cubic yard of material (R. 10a), and it is the amounts received by petitioners in accordance with Brewster's agreement which creates the issue.

The United States Tax Court, upon review, sustained the Commissioner's assertion of the deficiencies, 20 T. C. M. 336 (R. 20a-21a). The Court of Appeals affirmed the Tax Court. Both courts concluded that taxpayer's receipts were not proceeds of a "sale" and therefore were taxable as ordinary income (*infra*, p. 12a).

Reasons for Granting Writ.

1. The decision of the Court below is directly in conflict with the decision of the Court of Appeals for the First Circuit in *Linehan* v. *Commissioner*, 297 F. 2nd 276, as well as with the following decisions, in similar cases, by the Courts of Appeal for other Circuits as follows:

Crowell Land and Mineral Corp. v. *Commissioner*, 242 F. 2nd 864 (CA 5, 1957);

Gowans v. *Commissioner*, 246 F. 2nd 448 (CA 9, 1957);

Barker v. *Commissioner*, 250 F. 2nd 195 (CA 2, 1958);

Commissioner v. *Remer*, 260 F. 2nd 337 (CA 8, 1958).

In the *Linehan* case, and the other cases, the test which determined the tax treatment of transactions similar to that of the instant case was whether or not the taxpayer retained an economic interest in the material *after severance* from his property. In the instant case, however, the test formulated by the Court was whether or not the taxpayer retained an economic interest in the material *before severance* from his property.

Stating it another way, the Court below formulated the principle that the taxpayer has retained an economic interest, and therefore derives ordinary income, when title to the material does not pass before severance, even though compensation is at fixed unit prices (not dependent upon the value of the material or the extractor's use or profit); whereas the legal principle established in the other Circuits is that the taxpayer has retained no economic interest, and therefore derives capital gain income, because compensation is at fixed unit prices even though title does not pass before severance.

The conflict and its consequences are illustrated by a comparison of the instant case with *Linehan, supra,* with respect to which the Court below pointed out, "... the facts are not significantly different from those in the instant case ..." (Opinion, Note 4, Appendix A, p. 14a). In the instant case the Court below held[1] and in *Linehan* the fact was that

[1] The petitioner had argued that the amount of material to be taken was determined beforehand. If certiorari is granted the petitioner reserves the right to assert this contention.

the amount of material to be taken was not determined beforehand; and in both cases the price was set at a fixed rate per cubic yard of material extracted. In *Linehan* the Court held that because compensation was at a fixed price per cubic yard of material extracted (rather than for a percentage of the price received or the profits made on sale or use by exploiters), the taxpayer retained no economic interest after severance, consequently a sale occurred and the receipts from the transaction were capital gains. In the instant case, on the other hand, the Court held that the amount of material to be taken was not absolutely determined beforehand, therefore, even though compensation was at a fixed price per unit, the taxpayer had retained an economic interest because he had retained title up to the time of severance, consequently the receipts of the transaction were ordinary income. Thus, on practially identical facts, the two Courts of Appeal, applying different tests, reached conflicting decisions.

Similarly, the Courts of Appeal for the other Circuits have determined that a sale occurred, even though title remained in the taxpayer prior to severance when compensation depended upon the extractor's agreement to pay fixed price per unit of material extracted (*Crowell, Gowans, Barker* and *Remer, supra*).

The Court below commented that it saw no merit in the principle based on "fixed unit prices", and that other decisions (which include those hereinabove cited) are ". . . in conflict with the principles which we consider controlling" (Opinion, Note 4, Appendix A, p. 11a).

2. The question presented is of importance both to the general public which, regularly or occasionally, engages in any transactions similar to that of the instant case and to those who must administer the Federal tax laws. The

recurrence and importance of the question is shown by the large number of cases which have been passed upon by the Courts over the past years, including those already cited and others which were not reviewed on appeal.[2] Settlement of the question will prevent its further recurrence in future cases.

3. The decision of the Court below is believed to be erroneous, and the conflicting decisions[3] are believed to be correct. The economic interest test which has evolved from the interrelationship between the capital gains provisions and the depletion allowance provisions of the Internal Revenue laws (Opinion, Appendix A, pp. 6a-8a), has regularly been applied to fact situations similar to that of the instant case. In depletion cases it has been held that the taxpayer retained an economic interest when he has:

> (1) Acquired, by investment, any interest in the natural deposit in place; and
>
> (2) Secured by any legal relationship income derived from the extraction of the natural deposit to which he must look for return of his capital. *Gowans* v. *Commissioner*, 246 F. 2nd 448 citing *Commissioner* v. *Southwest Exploration Co.*, 350 U. S. 308, 314.

See also *Kirby Petroleum Co.* v. *Commissioner*, 326 U. S. 599.

In the instant case, and similar cases, there is no question with respect to the first element of the test because

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[2] *Robert M. Dann*, 30 T. C. 499, gov't appeal dismissed pursuant to stipulation, 4/14/59; *Samuel L. Green*, 35 T. C. 1065; *Otis A. Kittle*, 21 T. C. 79; *Maud U. Olinger*, 27 T. C. 93; *Griffith* v. *U. S.*, 180 F. Supp. 454; *Bel* v. *U. S.*, 160 F. Supp. 360.

[3] *Linehan* v. *Commissioner*, 297 F. 2d 276; *Crowell Land and Mineral Corp.* v. *Commissioner*, 242 F. 2d 864; *Gowans* v. *Commissioner*, 246 F. 2d 448; *Barker* v. *Commissioner*, 250 F. 2d 195; *Commissioner* v. *Remer*, 260 F. 2d 337.

the taxpayer owns the fee, although in depletion cases this element is the one which the Government usually asserts is absent. The second element of the test is absent in the instant case because the price is fixed at a unit rate, payable by Brewster whose personal covenant is the sole source for payment. When, as in the instant case, the taxpayer must look for compensation solely to the personal covenant of the exploiter he does not have an economic interest which gives rise to ordinary income subject to depletion. The court below, however, while adopting the rubric of the economic interest test has actually applied a novel formula, namely, a retention of title before severance test which takes into account only the first element of the two-fold test.

By substituting "retention of title before severance" for "retention of an economic interest", the court below has, in the name of the economic interest test, adopted a formula resulting in a decision which conflicts directly with those decisions based upon application of the established economic interest test to similar fact situations.

Conclusion.

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

MORRIS J. OPPENHEIM,
Attorney for Petitioners.

September 1962.